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IN THE

Supreme Court of the United States

OCTOBER TERM, 1961

No. 562

HARRY AND AMANDA SCHROEDER, *Petitioners*,

v.

COMMISSIONER OF INTERNAL REVENUE, *Respondent*.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE EIGHTH CIRCUIT

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DATED: November 20, 1961

PRESS OF BYRON S. ADAMS, WASHINGTON, D. C.

INDEX

	Page
CITATIONS TO OPINIONS BELOW	1
JURISDICTION	2
QUESTIONS PRESENTED	2
1. Whether the presumption of correctness attaches to the determination of a civil tax deficiency made by the Net Worth Method when determination is based on arbitrary estimates and is virtually impossible to disprove	3
2. Whether the presumption of correctness attaches to the determination of a civil tax deficiency made by the Net Worth Method where facts and leads are disregarded for approximations tailored to support the determination	4
3. Whether the Commissioner can circumvent and shift his statutory burden of proving civil fraud by relying on consistent understatements of income established on the basis of Commissioner's presumption of correctness of civil tax determinations	4
STATUTES INVOLVED	5
STATEMENT OF THE CASE	6
REASONS FOR GRANTING WRIT	15
1. No case involving civil liability under the Net Worth Method has been considered by the Supreme Court despite a basic unresolved conflict among the Circuits	16
2. The Commissioner should not be accorded the presumption of correctness in civil tax cases involving the use of the Net Worth Method where he relies on arbitrary estimates and ignores relevant facts	19

Page

3. The Commissioner's burden to prove fraud by clear and convincing evidence is illegally shifted or avoided by a finding of civil fraud being sustained on the basis of a determination by Commissioner which prevails under the presumption of correctness 20

Conclusion 23

4. The liberty and constitutional rights of 60,000,000 taxpayers-citizens require a mandate by this Court establishing the limits to which the Commissioner can go in determining a prima facie correct dollars and cents tax liability by arbitrary assessment instead of accounting computations or reasonable reconstruction 23

Appendix 1a

CITATIONS

Cases:

Carter v. Campbell, 264 F. 2d 930 (C.A. 5, 1959) 21
Harp v. C.I.R., 263 F. 2d 139 (C.A. 6, 1959) 18
Holland v. United States, 348 U.S. 151 (1954) 4, 16, 20
Marcella v. Commissioner, 222 F. 2d 878 (C.A. 8, 1955) 17
Polizzi v. C.I.R., 265 F. 2d 496 (C.A. 6, 1959) 19
Schroeder v. Commissioner, 291 F. 2d 649 (C.A. 8, 1961) 1, 17
Schultz v. Commissioner, 278 F. 2d 927 (C.A. 5, 1960) 19
Shahadi v. C.I.R., 266 F. 2d 495 (C.A. 3, 1959) 18
Thomas v. Commissioner, 232 F. 2d 520 (C.A. 1, 1956) 18
Thomas v. C.I.R., 266 F. 2d 297 (C.A. 6, 1959) 19

Statutes, Etc.

Constitution of the United States, Amendment V 5
26 U.S.C. 7453, Rule 32 5
26 U.S.C. 7454 6
28 U.S.C. 1254(1) 2
Internal Revenue Code, 1939, Section 41 5

Texts:

I Rabkin and Johnson, Federal Income Taxation, p. 1227(b) 16

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To the Honorable, Chief Justice and Associate Justices of the Supreme Court of the United States:

Petitioners, Harry Schroeder and Amanda Schroeder, pray that a Writ of Certiorari issue to review the judgment of the United States Court of Appeals for the Eighth Circuit, entered in the above-entitled cause on June 23, 1961.

CITATIONS TO OPINIONS BELOW

The Memorandum Opinion of the Trial Court, the Tax Court of the United States, is reported in 16 TCM 707.

The Opinion of the Circuit Court of Appeals for the Eighth Circuit is reported at 291 F. 2d 649.

JURISDICTION

The Judgment of the Circuit Court of Appeals was made and entered on June 23, 1961 and a copy thereof is appended to this petition in the Appendix at p. 1a. The time for filing this Petition for Writ of Certiorari was extended to and including November 20, 1961 by Orders of Mr. Justice Charles E. Whittaker.

The jurisdiction of this Court is invoked under 28 U.S.C., Section 1254(1).

QUESTIONS PRESENTED

Petitioners herein, a farmer and his wife, sought relief in the Tax Court of the United States from determinations of income tax deficiencies and imposition of civil fraud penalties made by Respondent, the Commissioner of Internal Revenue, for the years 1942 and 1944-1947, inclusive. These deficiencies were determined by employing a net worth method of a most extreme variety; that is, not only was Petitioners' net worth for each taxable year determined by approximation but the principal asset comprising every year's opening net worth (the livestock inventory) was arbitrarily set by a novel, esoteric and ad hoc formula,[1] rather than reasonably determined.

The Commissioner and the courts below justify this method on only one ground: they contend and hold that once the Commissioner has determined that the net worth method is to be used in a civil tax case, Respondent has the right (in the language of the Tax Court opinion) to

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[1] At trial before the Tax Court, the Commissioner conceded that the basic issue of the case was the principal opening asset in each year; the cattle inventories; stating in *haec verba* that if his method used to re-compute these inventories was illogical or unreasonable, "the deficiencies should be stricken". Any penalties would fall with the deficiencies. Thus, the Commissioner's method of livestock inventory computation was not only the basic, but the only real issue below, all other matters being shadow to substance.

do the job "in some fashion", even though completely arbitrary estimates are resorted to.

The courts below accepted the Commissioner's determination of net worth bottomed in all its essential components on completely arbitrary estimates, on the grounds that (in the language of the Court of Appeals) "the Commissioner's determination of a deficiency is prima facie correct and the burden is upon the taxpayer to disprove that determination". From this uncritical and open-end extension of the net worth method in civil tax cases, a matter never heretofore reviewed by this Court, the following questions arise:

1. Whether a presumption of correctness attaches to the determination of a civil tax deficiency by the Commissioner of Internal Revenue made by the Net Worth Method, when such determination is based entirely upon arbitrary estimates, without basis in law, fact, economic reality or theory; particularly where such estimates and determinations are virtually impossible to disprove.

The Judgment of the Court of Appeals holds that the presumption of correctness attaches to a civil net worth determination, regardless of the arbitrary and unrealistic basis of such a determination, and to the Commissioner's determination of necessity to resort to the Net Worth Method. Petitioners assert that this is a violation of Due Process, that their entire property and life savings have been confiscated by the employment of sham accounting, using arbitrary estimates of inventories which, the Commissioner fully concedes, may be totally incorrect. These estimates are clearly inconsistent with undisputed facts of record below—but because of the lacking connection with fact or economic reality, they are generically impossible to disprove.

There is a conflict of the Circuits with respect to this question, the Fifth and Sixth Circuit Courts of Appeals having held that the presumption of correctness does not apply to a net worth determination based on guesswork.

2. Whether the presumption of correctness attaches to the determination of a civil tax deficiency by the Commissioner of Internal Revenue made by the Net Worth Method, where the Commissioner rejects and ignores relevant facts and leads and simply relies on approximations and circumstantial inferences tailored to support his assessments.

The Judgment of the Court of Appeals holds in effect that the Doctrine of *Holland* v. *United States*, 348 U.S. 151 (1954), does not apply to civil tax cases and that the presumption of correctness attaches to a civil net worth determination although the Commissioner and the Tax Court rejected or ignored incontrovertible public records and other factual evidence and leads inconsistent with the Commissioner's conclusions. Petitioners assert that this is a violation of Due Process and that the Courts below completely ignored the principles enunciated by this Court in *Holland* v. *United States, supra;* that the *Holland* Doctrine has been subject to such erosion by the lower Courts during the seven years which have elapsed since that decision, that it is imperative that this Court revisit, re-affirm and clearly apply *Holland* to the protection not only of the citizen's liberty, but also to his equally constitutionally protected right to the fruit of his labor, his property.

3. Whether the Commissioner can circumvent the statutory mandate and shift his statutory burden of proving fraud in a civil case, by depending on a purported showing of "consistent understatement of income" where such "understatements" are supported

solely by the presumption of correctness of the Commissioner's determination of income.

The Judgment of the Eighth Circuit Court of Appeals holds that the Commissioner can carry his burden of "proving civil fraud by clear and convincing evidence" if he simply rests on a purported showing of "consistent understatement of income", although such alleged understatements of income in turn have been upheld solely because of the taxpayer's inability to rebut the presumption of correctness of that very determination by the Commissioner. Thus, the Court of Appeals for the Eighth Circuit holds that the heavy burden of proof imposed by Statute and by the reported decisions of this Court and other Circuit Courts of Appeal can be shifted upon the taxpayer whenever the Commissioner determines taxable income different from that reported by the taxpayer over a number of taxable years. Conversely, a taxpayer, faced with Respondent's determinations for more than one taxable year, has the burden of disproving civil fraud.

STATUTES INVOLVED

Amendment V of the Constitution of the United States provides in part as follows:

> ". . . nor [shall any person] be deprived of life, liberty, or property, without due process of law".

Section 7453, Rule 32 of Title 26, U.S. Code provides in part as follows:

> "The burden of proof shall be upon the petitioner, except as otherwise provided by statutes . . .".

41 IRC 1939 provides:

> "The net income shall be computed • • • in accordance with the method of accounting regularly em-